MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2016/2017

BAC3624 – ADVANCED AUDITING

(All Sections / Groups)

10th October 2016
2.30PM – 5.30PM
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of 5 pages excluding cover page with 5 Questions only.

2. Answer all **FIVE** questions. Mark distribution for each question is given.

3. Please print all your answers in the Answer Booklet provided.

QUESTION 1

a) You are an audit manager in Johan & Co, a firm of Chartered Accountants. You are preparing the engagement letter for the audit of Merdeka, a public limited liability company, for the year ending 30 June 2015. Over the past few years, Merdeka has grown rapidly, and is now one of your firm's most important clients.

Merdeka has been an audit client for the past six years and Johan & Co has provided audit, taxation and management consultancy advice during this time. The client has been satisfied with the services provided, although the taxation fee for the period to 31 December 2014 remains unpaid.

Audit personnel assigned for this year's audit are mostly of the staff from last year, including Sharon (an audit partner) and Bryan (an audit senior). Sharon has been the audit partner since Merdeka became the firm's audit client. You are aware that Michelle (Sharon's eldest daughter) has recently been appointed as the financial director at Merdeka.

To celebrate her new appointment, Michelle has suggested taking all of the audit staff out to an expensive restaurant prior to the start of the audit work for this year.

Required :

Identify and explain three (3) risks to independence arising in carrying out your audit of Merdeka for the year ending 30 June 2015, and suggest ways to address/reduce the risks that you have identified.

(12 marks)

b) Explain the situation where an auditor may disclose confidential information about a client.

(8 marks)

(Total: 20 marks)

QUESTION 2

a) Geronimo is a listed limited liability company with a year end of 30 June. Geronimo's main activity is selling home improvement or 'Do-It-Yourself' (DIY) products to the public. Products sold range from nails, paint and tools to doors and showers; some stores also sell garden tools and furniture. Products are purchased from approximately 200 different suppliers. Geronimo has a total of 105 stores all over ASEAN countries.

Geronimo has a well-staffed internal audit department, who report on a regular basis to the audit committee. Areas where the internal and external auditors may carry out work include the following:

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1) Attending the year-end inventory count in 30 stores annually. All stores are visited on a rotational basis.
2) Checking the internal controls over the procurement systems (e.g. ensuring a liability is only recorded when the inventory has been received).
3) Reviewing the operations of the marketing department.

For each of the above three areas, you are required to discuss the following:

i. The objectives of the internal auditor. (5 marks)

ii. The objectives of the external auditor. (5 marks)

iii. Whether the external auditor will rely on the internal auditor, and if reliance is required, the extent of that reliance. (5 marks)

b) ISA 610 *Using the Work of Internal Auditors* states that 'when the external auditor intends to use specific work of internal auditing, the external auditor should evaluate and perform audit procedures on that work to confirm its adequacy for the external auditor's purposes'.

Required :

In relation to ISA 610, explain the factors the external auditor will need to consider when evaluating the work of the internal auditor. (5 marks)

(Total: 20 marks)

QUESTION 3

a) Assume that the date is now 20 December 2015, the financial statements and the audit report have just been signed, and the Annual General Meeting is to take place on 10 January 2016. The Department of Environment has issued a report stating that JayZee Bhd is in breach of environmental legislation and a fine of RM800,000 will now be levied on the company. The amount is material to the financial statements.

Required :

Explain the additional audit work the auditor should carry out in respect of this fine. (4 marks)

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b) The date is 3 December 2015. The audit of JayZee Bhd is nearly complete and the financial statements and the audit report are due to be signed next week. However, the following additional information on two material events has just been presented to the auditor. The company's year-end was 30 September 2015.

Event 1 – Occurred on 5 November 2015
Production at the Beranang factory was halted for one day when a truck carrying dye used in colouring the fabric on mattresses punctured its front tyre, which resulted the dye to spread across the factory premises and into a local river. The Department of Environment is currently considering whether the release of dye was in breach of environmental legislation. The company's insurers have not yet commented on the event.

Event 2 – Occurred on 10 October 2015
The springs in a new type of mattress have been found to be defective, making the mattress unsafe for use. There have been no sales of this mattress; it was due to be marketed in the next few weeks. The company's insurers estimate that inventory to the value of RM750,000 has been affected. The insurers also estimate that the mattresses are now only worth RM225,000. No claim can be made against the supplier of springs as this company is in liquidation with no prospect of any amounts being paid to third parties. The insurers will not pay JayZee Bhd for the fall in value of the inventory as the company was underinsured. All of this inventory was in the finished goods store at the end of the year and no movements of inventory have been recorded post year-end

For each of the two events above, you are required to :

i. Explain whether the events are adjusting or non-adjusting according to IAS 10 *Events After the Reporting Period.*

(4 marks)

ii. Explain the auditors' responsibility and the audit procedures and actions that should be carried out according to ISA 560 (Redrafted) *Subsequent Events.*

(12 marks)

(Total: 20 marks)

QUESTION 4

a) ISA 620 *Using the Work of an Auditor's Expert* explains how an auditor may use an expert to obtain audit evidence. Explain three (3) factors that the external auditor should consider when assessing the competence, capabilities and objectivity of the expert.

(6 marks)

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b) Body Curve Sdn Bhd, a company dealing with fitness and health care products, has contacted your audit firm and asked for assistance in setting up its website. The CEO of Body Curve is mainly concerned that potential customers may be reluctant to place orders over the Internet. He is interested to find ways to provide assurance to customers about the security of their website.

For each of the following, you are required to:

i. Explain two reasons why customers are reluctant to engage in electronic commerce.

(4 marks)

ii. Explain the type of assurance your audit firm can provide to Body Curve's customers with regards to the company's website.

(4 marks)

iii. Elaborate the audit process that auditors should perform in providing assurance service for a company's website.

(6 marks)

(Total 20 marks)

QUESTION 5

a) Rebung Review Online (RRO) was founded in 2010 by Azeera Malik. She felt that many customers buying from online stores were misled by advertising and that too often, purchased products turned out to be unreliable, faulty or failed to meet the customers' expectations. Azeera believed that the online retail industry was increasingly acting unethically, caring only for profits at the expense of the needs and expectations of customers.

Consequently, she set up RRO to 'provide an unbiased review of online stores to ensure the customer has all available information'. The company offers reviews of current online stores and provides direct links for customers to shop at the stores featured on its site. The reviews include price comparisons provided by RRO, as well as general reviews provided by registered users of the site.

RRO relies upon its website being available online 24 hours a day, 7 days a week. For this reason, it has backup servers running concurrently with the main servers on which data is processed and stored. The servers are directly linked so that any update to the main servers automatically occurs on the backup. The servers are all housed in the same computer centre at the company's head office. The computer centre has enhanced its security by implementing a fingerprint recognition system for controlling access to the site. However, as the majority of staff at headquarters are IT personnel, and often temporary staff are hired to cover absentees, the fingerprint recognition system is not comprehensive and, to save time, is often bypassed.

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Similarly, to save time needed to set up new permanent staff with passwords to access the company's systems, a general 'administrator' user has been created, with the password 'password'. Many temporary staff access the system in this way.

RRO has an intelligent software application which constantly searches the internet for product price changes, uploading these into the reviews of the online store in question. Sometimes, however, there have been problems. Usually this is when the application has not recognised an outdated page and has replaced the correct latest price with an old price found on the outdated page. Furthermore, this intelligent software application needs permanent continual access to the internet, and RRO has identified a problem with its firewall which has prevented the software application from sometimes updating the internal systems. For this reason, it has removed the firewall protection to help ensure that the correct up-to-date prices of all online stores are shown on the website. RRO rarely generates other elements of reviews (such as product experience), leaving this to registered users of the site. However, it will, occasionally, submit its own review to help boost a store which pays a higher commission rate than its competitors. RRO is always honest in its reviews, but the more reviews a store has, the higher up the search list it appears, when a customer searches for a specific product.

Registered users can submit as many reviews as they wish. Unregistered users may also submit reviews, which will be published under the name 'anonymous', but these reviewers will be unable to comment on the reviews of others. RRO checks reviews for appropriate content, but does not contact the store to verify the accuracy of the review. RRO is about to undertake an audit of the adequacy of its general and application IT controls.

Based on the case above, evaluate the adequacy of the general and application controls within RRO, with respect to its information technology and information systems. Suggest any improvements you consider would be necessary.

(15 marks)

b) Sampling risk is the risk that the auditor's conclusions based on a sample may be different from the conclusion if the entire population were the subject of the same audit procedure. Based on ISA 530 *Audit Sampling*, briefly explain the two types of sampling risk that can lead to erroneous conclusion. (5 marks)

(Total: 20 marks)

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